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Supreme Court of the United States

OCTOBER TERM, 1944

NO. 286

ALUMINUM COMPANY OF AMERICA, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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INDEX

PAGE

Petition for Writ of Certiorari 1

Opinions Below 1

Jurisdiction 2

Statute Involved 2

Statement 3

Questions Presented 6

Reasons Relied on for the Allowance of the Writ 7

Brief in Support of Petition for Writ of Certiorari .. 11

Specification of Errors to be Urged 11

Argument 13

1. The decision of the Circuit Court of Appeals that the petitioner was a "subcontractor" under the Vinson Act is in conflict with a decision of this Court under a comparable statute and decides an important question of federal law which has not been, but should be, settled by this Court 13

2. The decision of the Circuit Court of Appeals is in conflict with applicable decisions of this Court in that it applies to the petitioner a regulation which enlarged an Act of Congress and which was not followed in administrative practice 18

PAGE

3. The decision of the Circuit Court of Appeals is in conflict with applicable decisions of this Court in that it refused to allow the petitioner, there respondent on review, to support the decisions of the Board of Tax Appeals on grounds presented to the Board 21

4. The decision of the Circuit Court of Appeals is in conflict with applicable decisions of this Court in that it gives retroactive application to a statute not providing for such application..... 24

Conclusion 25

Appendix A—Section 3 of the Act of March 27, 1934, c. 95 26

Section 3(b) of the Act of June 25, 1936, c. 812 28

T. D. 4723, 1937-1 Cum. Bull. 519, 521 29

I. T. 2930, XIV-2 Cum. Bull. 533 (1936) 30

Opinion of the Legal Division of the Navy Department 31

Appendix B—Excerpts from briefs of Petitioner in the Board of Tax Appeals and in the Circuit Court of Appeals for the Third Circuit 39

Appendix C—Cases holding that a materialman is not a "subcontractor"..... 42

TABLE OF CITATIONS

Cases.

PAGE

Aero Supply Manufacturing Corp., Commerce Clearing House, B.T.A. Service, No. 12820-D..... 13

Burnet v. Chicago Portrait Co., 285 U. S. 1..... 9

Clifford F. MacEvoy Co. v. United States, 64 S. Ct. 890 .....8, 14

Colgate-Palmolive-Peet Co. v. United States, 320 U. S. 422..... 25

Dobson v. Commissoner, 320 U. S. 489..... 16

Doyle v. Mitchell Bros. Co., 247 U. S. 179.....10, 25

Hassett v. Welch, 303 U. S. 303.....10, 25

Hays v. Gauley Mountain Coal Co., 247 U. S. 189... 25

Helvering v. Lerner Stores Co., 314 U. S. 463.....9, 22

Helvering v. Pfeiffer, 302 U. S. 247..... 24

Helvering v. Sabine Transportation Co., Inc., 318 U. S. 306.....9, 19

LeTulle v. Scofield, 308 U. S. 415.....9, 24

Lynch v. Turrish, 247 U. S. 221.....10, 25

Maass v. Higgins, 312 U. S. 443.....9, 19

Manhattan General Equipment Co. v. Commissioner, 297 U. S. 129..... 19

Ryerson v. United States, 312 U. S. 405..... 24

United States v. Cleveland etc. Ry. Co., 247 U. S. 195 25

United States v. Clifford F. MacEvoy, 137 F. (2d) 565 15

United States v. Pleasants, 305 U. S. 357.....9, 21

United States v. Stewart, 311 U. S. 60..... 15

Statutes.

PAGE

Act of March 27, 1934, Section 3, chapter 95, 48 Stat. 505, 34 U.S.C. §496—Vinson Act.....2, 26

Act of August 24, 1935, chapter 642, §2, 49 Stat. at L. 794, 40 U.S.C.A. §270b—Miller Act..... 15

Act of June 25, 1936, Section 3(b), chapter 812, 49 Stat. 1926, 34 U.S.C. §496—Amendment to Vinson Act 2, 28

Act of June 29, 1936, Section 505(a) and Section 505(b), 49 Stat. 1998—Merchant Marine Act.. 17

Second Revenue Act of 1940, Section 401, 54 Stat. 1003, 34 U.S.C. §496a..... 14

United States Code, Title 26, Section 1141(a) and Title 28, Sections 347 and 350..... 2

Miscellaneous.

141 A. L. R. 321.....16, 17

Hearings Before the Committee on Naval Affairs of the House of Representatives on Sundry Legislation Affecting the Naval Establishment, 1940, 76th Congress, 2 & 3rd Sessions, p. 3170..... 19

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NO. .....

ALUMINUM COMPANY OF AMERICA, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Aluminum Company of America, by its attorney, respectfully prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered on April 28, 1944, in the case between the above named parties, docketed therein as No. 8302. The said judgment reversed decisions of the United States Board of Tax Appeals (now the Tax Court of the United States), entered on September 16, 1942.

Opinions Below

The findings and opinion of the United States Board of Tax Appeals are officially reported at 47 B.T.A. 543

and are printed in the record (R. 4-26). The opinion of the Circuit Court of Appeals is officially reported at 142 F. (2d) 663 and is printed in the record (R. 49-63).

Jurisdiction

The jurisdiction of this Honorable Court is invoked under United States Code, Title 26, Section 1141(a), and Title 28, Sections 347 and 350.

Statute Involved

The statute involved is Section 3 of the Act of March 27, 1934, c. 95, 48 Stat. 505, 34 U.S.C. §496, commonly known as the "Vinson Act", as amended by Section 3(b) of the Act of June 25, 1936, c. 812, 49 Stat. 1926, 34 U.S.C. §496. These provisions, as originally enacted and as amended, are printed in Appendix A (*infra,* pp. 26-29).

The specific portions of the statute calling for construction read as follows:

> "*Provided,* That no contract shall be made by the Secretary of the Navy for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—
>
> (a) To make a report, as hereinafter described, under oath, to the Secretary of the Navy upon the completion of the contract.
>
> (b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the

total contract price, such amount to become the property of the United States:

* * * * * * *

(e) To make no subcontract unless the subcontractor agrees to the foregoing conditions.

The report shall be in form prescribed by the Secretary of the Navy and shall state the total contract price, the cost of performing the contract, the net income, and the per centum such net income bears to the contract price."

Statement

Aluminum Company of America, hereinafter referred to as the "petitioner", in the years 1936, 1937 and 1938 completed performance of certain contracts of sale of aluminum materials. Some of these were "prime contracts", which term means "a contract made directly with the Government of the United States and by its terms subject to the Vinson Act" (R. 7). Others were contracts of sale to prime contractors with the Government or to subcontractors or materialmen (R. 9-14); these were by their terms subject to the Vinson Act in so far as applicable (R. 41-47). The materials so sold eventually became parts of Vinson Act naval vessels or aircraft (R. 56).

All of the materials were regular commercial products, representing less than 2 per cent. of the petitioner's total sales of similar materials for the years in question and were identical in character and procedure of sale with those sold to many customers for different purposes (R. 11). All of them (except for certain negligible screw machine products, R. 9-11) required a great deal of further and extensive fabrication

by the petitioner's customers or their vendees resulting in radical distortion in size and shape and conversion into new and different forms (R. 10-15).

For the year 1936 and for the years 1937 and 1938 the Commissioner of Internal Revenue, hereinafter referred to as the "respondent", determined deficiencies in the petitioner's excess profit liability on the several prime contracts and other contracts (R. 4). The petitioner petitioned the Board of Tax Appeals for redetermination of these deficiencies for 1936 (R. 2) and 1937 and 1938 (R. 3). It did not dispute that its prime contracts were by their terms subject to the Vinson Act. The Board held that on the prime contracts there was no deficiency in excess profit liability for 1936 (R. 29) and that there were deficiencies in such liability for each of the years 1937 and 1938 (R. 29).

The petitioner contended before the Board that, in computing profit on all the contracts, both prime contracts and others, the cost of the metal supplied thereunder, which had been produced or acquired by the petitioner at various times, should be its "schedule cost", i. e., the fair market value on the date of its appropriation to the particular contract (Appendix B, *infra*, pp. 39-40); and that, *a fortiori*, the cost of the said metal should be taken to be not less than its fair market value when the Vinson Act was passed, for the reason that the Vinson Act and the regulations promulgated thereunder do not call for retroactive application of its recapture provisions (Appendix B, *infra*, pp. 40-41). The Board held, with respect to the prime contracts, that the cost of metal should be taken to be its original cost to the petitioner (R. 25), and it determined the deficiencies

for 1937 and 1938 accordingly. It did not mention the argument against retroactive application of the statute.

With respect to the other contracts, the Board, sustaining the petitioner, held that it was not liable for excess profit because it was not a "subcontractor" within the meaning of the Act. The respondent petitioned the Circuit Court of Appeals for the Third Circuit for review of this decision. That court reversed the Board upon the ground that the word "subcontractor" in the Vinson Act includes materialmen (R. 58).

With respect to the question of "cost", the petitioner contended before the Circuit Court of Appeals that there is no indication in the Act of an intention to give it retroactive application and therefore that

> "The excess profit on a subcontract for the construction or manufacture of a vessel or aircraft authorized by the Vinson Act does not include profit resulting from an increase in the value of the metal occurring prior to the passage of the Act." (Appendix B, *infra*, p. 41)

The Circuit Court of Appeals held that because the Board had "relevantly decided the question" against the petitioner with respect to the prime contracts and because the petitioner had not petitioned for review of the Board's decisions, this question was not open to the petitioner (R. 62-63).

Questions Presented

1. Where a materialman supplies to a prime contractor materials consisting only of regular commercial products requiring extensive further fabrication, involving radical distortion in their size and shape, and conversion into new and different forms before being made a part of a naval vessel or aircraft, is the materialman subjected to liability as a "subcontractor" within the meaning of the Vinson Act?

2. Where a materialman supplies such materials to other persons who in turn supply them to a prime contractor, a sub-contractor, or another materialman, is the materialman subjected to liability as a "subcontractor" within the meaning of the Vinson Act?

3. Is a regulation subjecting such a materialman to liability as a "subcontractor" under the Vinson Act a valid exercise of authority by the Secretary of the Navy and the Secretary of the Treasury?

4. Where the administrative practice under the regulation has been to treat a materialman as a subcontractor only if he dealt with a prime contractor, may the regulation be applied to a materialman with respect to transactions in which he did not deal with a prime contractor?

5. In a case in which the Board of Tax Appeals has decided that there is no deficiency, is the respondent on review in the Circuit Court of Appeals precluded, by reason of its failure to petition for review, from urging in support of the decision grounds presented to the Board?

6. In a case in which the Board has decided that there is a deficiency, is the respondent on review in the

Circuit Court of Appeals precluded, by reason of its failure to petition for review, from urging in support of the decision grounds presented to the Board?

7. Was the Vinson Act intended by Congress to apply retroactively so as to include in "excess profit" increments in value of the materials occurring prior to the enactment of the statute?

Reasons Relied On for the Allowance of the Writ

I.

The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

The principal question is whether materialmen were intended by Congress to be subjected to liability for excess profit under the Vinson Act, which imposes such liability on "subcontractors". This question has never been passed on by this Court, or by any federal tribunal in any other case except one decided by the Board of Tax Appeals, which followed its previous decision in the case at bar. The Commissioner did not seek review of that decision.

The Vinson Act was enacted on March 27, 1934, and the profit-limiting provisions of section 3 were suspended by section 401 of the Second Revenue Act of 1940, 54 Stat. 1003, 34 U.S.C. § 496 a, as to contracts and subcontracts completed during the effective period of the excess profits tax. In view of the very large number of concerns that supplied materials which eventually became parts of Vinson Act vessels and aircraft, the question here presented is of national importance and involves large sums of money. Its disposition by this

Court would make much litigation unnecessary and dispose of many cases involving the same question which, as we are informed, are now pending before the Bureau of Internal Revenue and in the Tax Court of the United States.

II.

The decision of the Circuit Court of Appeals held that the Vinson Act, imposing liability with respect to "subcontracts" of "subcontractors", applied to the petitioner's sales, made to prime contractors, subcontractors and materialmen, of regular commercial products requiring extensive further fabrication by the petitioner's customers or their vendees. This holding is in conflict with the decision of this Court under a comparable statute in *Clifford F. MacEvoy Co. v. United States,* 64 S. Ct. 890 (not yet officially reported), holding that a materialman is not a "subcontractor" within the meaning of the Miller Act. It is also in conflict with a great number of other decisions by federal and state appellate courts, which we believe to be unanimous in establishing that a materialman, under the circumstances described, is not to be classed as a "subcontractor".

III.

The decision of the Circuit Court of Appeals sustained a regulation promulgated under the Vinson Act, subjecting materialmen to liabilities that are imposed by the statute only on contractors and subcontractors. It did this in disregard of the explicit admission of the Commissioner of Internal Revenue that the regulation was an "enlargement of the ordinary routine definition" of the term "subcontractor" and his disclosure that under the administrative practice no attempt had been

made to apply the regulation to one not dealing with a prime contractor. The decision, in thus permitting the enlargement of an Act of Congress by administrative action, is contrary to the decisions of this Court in *Maass v. Higgins,* 312 U. S. 443, and *Helvering v. Sabine Transportation Co., Inc.,* 318 U. S. 306. The decision, in sustaining a regulation that was not consistently followed in administrative practice, is contrary to the decision of this Court in *United States v. Pleasants,* 305 U. S. 357, and *Burnet v. Chicago Portrait Co.,* 285 U. S. 1.

IV.

The Circuit Court of Appeals held that the petitioner was, by reason of its failure to petition for review, precluded from urging, in support of the decisions of the Board of Tax Appeals, grounds presented to the Board but not passed upon by it. This holding is important to federal procedure. As to the case for 1936, Docket No. 103,316 in the Board, the decision of the Board was that there was no deficiency (R. 29); the decision of the Circuit Court of Appeals that the petitioner was precluded from urging independent grounds of affirmance by reason of its failure to appeal is contrary to the decision of this Court in *Helvering v. Lerner Stores Co.,* 314 U. S. 463. As to the case for 1937 and 1938, Docket No. 106,514 in the Board, the decision of the Board was that there was a small deficiency for each year (R. 29); the decision of the Circuit Court of Appeals that the petitioner was precluded from urging independent grounds in support of the Board's decision by reason of its failure to appeal is contrary to the decision of this court in *LeTulle v. Scofield,* 308 U. S. 415, where the judgment was in part against the respondent. To that extent the judgment stood, since he had not

sought review. To the extent that it was favorable to him, the judgment was affirmed on grounds rejected by the court below in rendering the judgment in part against him.

V.

The decision of the Circuit Court of Appeals failed to hold that in determining excess profit, the materials used are to be included in the "cost of performing the contract" at their value on the date of enactment of the Vinson Act. The court thus sanctioned retroactive application of the Vinson Act by including in excess profit on the construction of vessels and aircraft increments in value of the materials arising before the Act was passed. This disposition of this federal question is in conflict with decisions of this Court, including *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179; *Lynch v. Turrish,* 247 U. S. 221, and *Hassett v. Welch,* 303 U. S. 303.

Wherefore the petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit, that the said judgment be reversed, and that such other and further relief be granted as may seem proper.

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Attorney for the Petitioner.

DAVID B. BUERGER,
Of Counsel.

July 25, 1944.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

NO. .....

ALUMINUM COMPANY OF AMERICA, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

There are set forth in the foregoing petition, and incorporated at this point by reference, statements as to the opinions of the courts below (p. 1), the grounds upon which the jurisdiction of this Court is invoked (p. 2), the statute involved (p. 2), and the material facts (p. 3).

Specification of Errors to Be Urged

The Circuit Court of Appeals erred:

1. In holding that the petitioner, a supplier of materials, was liable as a "subcontractor" under the Vinson Act

(a) with respect to its contracts with prime contractors, and

(b) with respect to its contracts with subcontractors and materialmen.

2. In holding that the petitioner was precluded, by reason of its failure to petition for review of the decisions of the Board of Tax Appeals, from urging in support of those decisions grounds presented to the Board

(a) in one proceeding in which the Board decided that there was no deficiency, and

(b) in another proceeding in which the Board decided that there was a deficiency which the respondent, petitioner on review, sought to have increased.

3. In failing to hold, and to instruct the Tax Court of the United States, that in determining excess profit, the materials used are to be included in the "cost of performing the contract" at their value on the date of enactment of the Vinson Act.

4. In reversing the decisions of the Board of Tax Appeals.

Argument

1. THE DECISION OF THE CIRCUIT COURT OF APPEALS THAT THE PETITIONER WAS A "SUBCONTRACTOR" UNDER THE VINSON ACT IS IN CONFLICT WITH A DECISION OF THIS COURT UNDER A COMPARABLE STATUTE AND DECIDES AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

The Vinson Act limits profit on contracts and subcontracts for the construction and/or manufacture of certain naval vessels or aircraft or any part thereof. It requires every prime contractor to agree, and to require his subcontractors to agree, to pay into the Treasury profit in excess of 10 per centum of the total contract price. The petitioner was a mere materialman who supplied to prime contractors, subcontractors, or other materialmen, regular commercial products which required extensive fabrication by its vendees or by their vendees, resulting in radical distortion in size and shape and conversion into new and different forms, before the materials could be made a part of a naval vessel or aircraft (R. 6-15). The principal question is whether, by reason of these transactions, the petitioner was a "subcontractor".

No question arising under the Vinson Act has ever been passed on by this Court, and no other federal tribunal, except in the case at bar, has ever decided the question raised; except that on August 18, 1942, the Board of Tax Appeals followed its decision in the case at bar in favor of the petitioner in *Aero Supply Manufacturing Corp.* (unofficially reported, Commerce Clearing House, B. T. A. Service, No. 12,820-D). The Commissioner did not seek review of that decision.

The Vinson Act was enacted March 27, 1934, and the profit-limiting provisions of Section 3 were suspended by Section 401 of the Second Revenue Act of 1940, 54 Stat. 1003, 34 U.S.C. §496a, as to contracts and subcontracts completed during the effective period of the excess profits tax. Many cases have arisen, as we are informed, which are pending either before the Bureau of Internal Revenue or in the Tax Court of the United States, whose disposition will be affected by the ultimate decision in the case at bar. The question affects virtually every supplier of materials who during nearly six pre-war years made substantial sales of materials that ultimately found their way into naval vessels or aircraft. The number of such material suppliers must be very large; we know of many in the Pittsburgh district alone. If the question is not disposed of by this Court, it is probable that much avoidable litigation in other circuits will ensue.

The decision of the Circuit Court of Appeals that the term "subcontractor" includes a materialman under the circumstances described is in conflict with the decision of this court in *Clifford F. MacEvoy Co. v. United States,* 64 S. Ct. 890 (not yet officially reported), and with what we believe to be the unanimous judicial authority in federal and state appellate courts.

The petitioner owes no excess profit on its material contracts unless those contracts were "subcontracts" and unless it was, with respect to them, a "subcontractor" within the meaning of the Vinson Act. There is nothing in the statute to indicate that those words were used by Congress in any other than their common, ordinary sense, and that meaning is to be adhered to. "Congress will be presumed to have used a word in its

usual and well-settled sense": *United States v. Stewart*, 311 U. S. 60, 63.

The only decision by this Court construing the term "subcontractor" is *Clifford F. MacEvoy Co. v. United States*, decided under the Miller Act. That Act provides broadly that "Every person who has furnished labor or material in the prosecution of the work provided for in such contract * * * shall have the right to sue on such payment bond;" the Act contains many other references to persons supplying material. It contains a proviso, however, "that any person having direct contractual relationship with a subcontractor" shall have a right of action on the payment bond. The Circuit Court of Appeals recognized that the proviso appeared to be in conflict with the remainder of the statute, and declined to give it any limiting effect. Accordingly, it held that one who supplied materials to a materialman had a right of action on the payment bond, because the term "subcontractor" should be liberally construed to include a materialman, in order to effectuate what it conceived to be the Congressional intent. *United States v. Clifford F. MacEvoy Co.*, 137 F. (2d) 565. This Court granted certiorari and reversed the judgment. In the instant case, the statute contains no such broad language, nor any reference to persons who furnish material, as the Miller Act does, yet the Circuit Court of Appeals, in a decision filed four days after this Court's decision in *Clifford F. MacEvoy Co. v. United States*, adhered to its former view and held that the petitioner, which did nothing more than supply ordinary materials, was a "subcontractor" within the meaning of the Vinson Act.

In its opinion the Circuit Court of Appeals sought to distinguish this Court's decision on the ground that

the term "subcontractor" has no single, exact meaning, and is to be construed so as to effectuate a legislative intent inferred, not from language of Congress, but from the court's view of the purpose of the statute (R. 56-57). The court thought that the Board's interpretation worked a serious discrimination against the Government as a builder of its own naval vessels, because suppliers of materials would sell as little as possible to the Government (R. 56-57). This unsupported view is contrary to that of the Board of Tax Appeals, the "administrative body having special competence to deal with the subject matter": *Dobson v. Commissioner,* 320 U. S. 489, 502. The Board concluded that restricting profit on "common articles, materials and supplies ordinarily purchased on the open market" might make them "practically unobtainable in the market because of the fear of a later forced return of profits", and that "Thus, the Navy might be hampered, not helped." (R. 18). Moreover, the court did not mention any of the numerous decisions of the federal and state courts, in a great variety of situations, construing divers statutes and contracts, on which this petitioner relied, and which the Board followed (R. 18, 20-21). (These decisions are listed in Appendix C, *infra,* p. 42.) We are satisfied that no court of appellate jurisdiction has ever applied the term "subcontractor" to a materialman supplying regular commercial materials requiring substantial further fabrication, except on the basis of special definition of the term in the statute or contract so as to include a materialman. We have examined the cases cited in the annotation at 141 A. L. R. 321, referred to in this Court's opinion in the *MacEvoy* case and relied on by the Circuit Court of Appeals (R. 57), as we have examined every decision

on the subject coming to our notice, and we are confident that the foregoing statement is correct. The conflict exhibited by the cases exists only in a field within which the facts of this case do not fall. The annotation at 141 A.L.R. 321 does show that the line of demarcation between a subcontractor and a materialman is not drawn at the same point by all courts; the conflict is over where the line is to be drawn. But there is no conflict as to the classification to be given this petitioner on the facts found; it would not have been classed as a subcontractor under any of the cases cited in the annotation.

As noted by this Court in the *MacEvoy* case, "Congress has shown its ability in other statutes to make clear an intent to include materialmen within the meaning of the word 'subcontractor' ". No such intent is made clear in the Vinson Act. As this Court also noted, "In other statutes, Congress has clearly used the term 'subcontractor' in contrast to 'materialman' ". Such instances were relied on by the Board (R. 21) but disregarded by the Circuit Court of Appeals. As stated by the Board,

> "The legislation most nearly parallel to the Vinson Act is the Merchant Marine Act of June 29, 1936, 49 Stat. 1998. That act has features resembling both the Vinson Act and the Buy American Act. Its section 505(b) reads:
>
> > No contract shall be made for the construction of any vessel under this act unless the shipbuilder shall agree * * * (5) to make no subcontract unless the subcontractor agrees to the foregoing conditions.

Section 505(a) provides:

> * * * In all such construction the shipbuilder, subcontractors, materialmen, or suppliers shall use, so far as practicable, only articles, materials, and supplies of the growth, production, or manufacture of the United States * * *."

Thus, in parallel legislation passed in 1936 before the disputed regulation of 1937 was promulgated, and using in Section 505(b) the identical language appearing in the Vinson Act, Congress was at pains to subject both subcontractors and materialmen to Section 505(a), while leaving Section 505(b) applicable only to subcontractors.

The decision of the Circuit Court of Appeals so far departs from the ordinary meaning of the term "subcontractor" as established by the decision of this Court and the overwhelming weight of judicial authority elsewhere as to call for its review.

2. THE DECISION OF THE CIRCUIT COURT OF APPEALS IS IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT IN THAT IT APPLIES TO THE PETITIONER A REGULATION WHICH ENLARGED AN ACT OF CONGRESS AND WHICH WAS NOT FOLLOWED IN ADMINISTRATIVE PRACTICE.

The Vinson Act limits the profit to be made on the construction or manufacture of certain naval vessels or aircraft by a "subcontractor". The petitioner, who was a mere materialman, contends, and the Board of Tax Appeals held, that the word "subcontractor" does not apply to the petitioner. The Circuit Court of Appeals relied on a regulation (*infra*, p. 29) issued under the Vinson Act which treated every materialman as a sub-

contractor. In giving effect to the regulation, the Circuit Court of Appeals departed from the applicable decisions of this Court in two important respects:

(a) The respondent Commissioner, in his brief filed in the Board of Tax Appeals, admitted that the term "materialman" is a "distinct legal concept" and that there is a "distinction in fact between subcontractor and materialman", but said that the regulation had "enlarged on the ordinary routine definition" of "subcontractor". The Board noted this admission and held that this "enlargement" by the regulation was not warranted (R. 20). In their Statement of Points to be Relied on, filed in the Circuit Court of Appeals, the Assistant Attorney General and the Chief Counsel, Bureau of Internal Revenue assigned as error the action of the Board "In holding and deciding * * * that the 'enlargement of the ordinary routine definition' [in the regulation] of a subcontractor is not warranted." But, we earnestly submit, it is not the function of the Treasury to "enlarge" an Act of Congress. The present attempt to do so "is an unwarranted extension of the plain meaning of the statute and cannot, therefore, be sustained": *Maass v. Higgins,* 312 U. S. 443, 447. A regulation which "operates to create a rule out of harmony with the statute, is a mere nullity": *Manhattan General Equipment Co. v. Commissioner,* 297 U. S. 129, 134. Any attempts of the Treasury to "enlarge" an Act of Congress is "an attempt to legislate": *Helvering v. Sabine Transportation Co., Inc.,* 318 U. S. 306, 311-312. As Chairman Vinson of the House Committee on Naval Affairs put it, at the very hearings relied on by the Circuit Court of Appeals (R. 60):

> "When we should write anything into the statutes, it is better to do it that way than to leave

it to Department rules and regulations, because the Department's rules and regulations mean one thing and the law means another." (Hearings before the Committee on Naval Affairs of the House of Representatives on Sundry Legislation affecting the Naval Establishment, 1940, 76th Congress, 2nd & 3rd Sessions, p. 3170.)

(b) Administrative construction of a statute to give that construction validity, must be consistent. But in the Circuit Court of Appeals the Commissioner, relying on an opinion of the Legal Division of the Navy Department, disclosed that in practice the term "subcontractor" was limited to one dealing with the prime contractor:

> "It would not appear that in the application of the Vinson-Trammel Act any attempt was made to go beyond the first tier of subcontractors; that is, there is nothing to indicate that it was to be applied to sub-subcontractors" (Appendix A, *infra*, p. 35.)

Under what the Commissioner termed "long-continued administrative construction", none of the petitioner's orders from persons who were not prime contractors would be deemed subcontracts. These involve the great bulk of the profit in this case, and this was pointed out to the court. Further, as noted in its opinion by the Board of Tax Appeals, the practice of both the War and Navy Departments from 1934 to 1941 was to recognize the distinction between a subcontractor and materialman (R. 21-22). Since it appeared from the Commissioner's brief that there has not been "any attempt" since 1934 to apply the regulation to persons not dealing with a prime contractor, the Circuit Court of Appeals erred in saying that the interpretation it adopted had

been uniformly followed." In following the regulation under those circumstances, its decision is in conflict with the decision of this Court in *United States v. Pleasants*, 305 U. S. 357, 363. It was there held that "The administrative construction invoked by the Government has not been of a sufficiently consistent character to afford adequate support for its contention."

3. THE DECISION OF THE CIRCUIT COURT OF APPEALS IS IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT IN THAT IT REFUSED TO ALLOW THE PETITIONER, THERE RESPONDENT ON REVIEW, TO SUPPORT THE DECISIONS OF THE BOARD OF TAX APPEALS ON GROUNDS PRESENTED TO THE BOARD.

The Circuit Court of Appeals held that the petitioner, which was the respondent on review in that court, had lost the right to support the decisions on grounds presented to the Board of Tax Appeals, because it had failed to petition for review. This holding is important to federal procedure and is in conflict with applicable decisions of this Court.

In the case for the year 1936, Docket No. 103,316 in the Board, the petitioner contended that it was not a "subcontractor" within the meaning of the Vinson Act. In this it was sustained by the Board, which thereupon entered its decision that there was no deficiency (R. 29). In the case for the years 1937 and 1938, Docket No. 106,514 in the Board, the same argument was made and sustained, but deficiencies as to the petitioner's prime contracts were determined by the Board for those years (R. 29).

In both cases the petitioner had also contended that even if it were a "subcontractor", its "excess profit"

should not include any increment in the value of the materials used by it in performance of the contracts, occurring before March 27, 1934, the date of enactment of the Vinson Act (Appendix B, *infra,* pp. 40-41). The Board did not discuss or pass on this particular contention, but held that original cost must be used in computing the profit on the prime contracts. In the brief of this petitioner in the Circuit Court of Appeals, where it was respondent on review, the argument was renewed (Appendix B, *infra,* pp. 41-42). No question as to liability on the prime contracts was presented to the court. The Commissioner filed a reply brief discussing this argument on the merits, but not suggesting that the question was not open. The proposition that this petitioner had no right to urge the argument was not discussed by either party at the bar, but was originated and decided by the Circuit Court of Appeals in its opinion, in which it refused to consider the merits of the argument on the ground that the Board relevantly decided the question adversely to the petitioner and that the petitioner had not filed a petition for review.

As to the case for 1936, Docket No. 103,316, the decision of the Board was that there was no deficiency. How could the petitioner have sought review? Of what error could it have complained? The decision of the Circuit Court of Appeals is in conflict with the decision of this Court in *Helvering v. Lerner Stores Co.,* 314 U. S. 463, where it was declared (p. 466) that "a respondent, without filing a cross-petition, may urge in support of the judgment under review grounds rejected by the court below. *Langnes v. Green,* 282 U. S. 531, 538-539; *Public Service Commission v. Havemeyer,* 296 U. S. 506, 509; *McGoldrick v. Compagnie Generale Transatlantique,* 309 U. S. 430, 434."

As to the case for the years 1937 and 1938, Docket No. 106,514, there was a decision as to which this petitioner could have filed a petition for review. The ultimate question before the court, however, was whether for any reason raised in the Board of Tax Appeals and renewed before the court, the Board had erred in limiting the deficiencies to the amounts determined. The petitioner was entitled to show, on a ground actually presented to the Board, that the deficiencies should not be increased to the amounts sought by the Commissioner. The court held, however, that because the deficiencies were the result of a legal conclusion of the Board as to the meaning of "cost" as applied to the prime contracts, the petitioner was precluded from questioning the correctness of that legal conclusion as applied to the other contracts. In this the decision of the court is contrary to the decision of this Court in *LeTulle v. Scofield,* 308 U. S. 415. In that case the District Court had held an entire transaction to be a "reorganization" and had entered judgment against the Collector. On appeal, the Circuit Court of Appeals held that the transaction was a "reorganization" except as to certain assets transferred by the taxpayer individually to the transferor corporation as a preliminary to the transaction. This Court granted certiorari on the petition of the taxpayer; the Collector did not seek the writ. This Court thereupon held that the Collector could sustain the judgment to the extent favorable to him, on a ground repudiated by the Circuit Court of Appeals, namely, that the transaction was not to any extent a "reorganization". The judgment against the Collector, though based on a ground found by this Court to be wrong, was permitted to stand because he had not brought it under review. In the case at bar, the peti-

tioner did not seek reversal by the Circuit Court of Appeals of the decision against it for 1937 and 1938; it was entitled nevertheless to support that decision, to the extent that it was favorable, upon a legal ground inconsistent with the decision of the Board. That part of the decision against it may stand, though based on an error of law, just as did the judgment against the Collector in *LeTulle v. Scofield, supra.*

Neither *Helvering v. Pfeiffer,* 302 U. S. 247, nor *Ryerson v. United States,* 312 U. S. 405, cited by the Circuit Court of Appeals, supports its decision. In the *Pfeiffer* case, this Court held (at pp. 250-251) that "a decision below may be sustained, without a cross-appeal, although it was rested upon a wrong ground." And in the *Ryerson* case this Court held (at p. 408) that "even though the judgment below was rested upon the erroneous ground that the trusts were 'persons' * * *, the Government may justify the judgment here on the ground that * * * the gifts were of future interests."

4. THE DECISION OF THE CIRCUIT COURT OF APPEALS IS IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT IN THAT IT GIVES RETROACTIVE APPLICATION TO A STATUTE NOT PROVIDING FOR SUCH APPLICATION.

The question that the Circuit Court of Appeals refused to consider is one of substantial merit. The court's decision results in a retroactive application of the Vinson Act not required by its terms. A large part of the metal used in performing the contracts under dispute was on hand and owned by the petitioner on March 27, 1934, the date of passage of the Vinson Act. Much of the "excess profit" claimed by the Commissioner consisted of increment in value of the metal occurring

before that date. The Vinson Act calls for an outright taking rather than the imposition of a tax; yet this Court has repeatedly decided that, for the purpose of computing taxable gain, "cost" may not be less than the value of the thing sold on the effective date of the first statute taxing the income derived from the sale. *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179; *Hays v. Gauley Mountain Coal Co.,* 247 U. S. 189; *United States v. Cleveland etc. Ry. Co.,* 247 U. S. 195; *Lynch v. Turrish,* 247 U. S. 221. The rule of construction for which the petitioner contends, and which the Circuit Court of Appeals refused to apply, is that applied in *Hassett v. Welch,* 303 U. S. 303, 314, as one of the "settled rules of statutory construction, which teach that a law is presumed in the absence of clear expression to the contrary to operate prospectively." "Tax statutes look to the future and not to the past": *Colgate-Palmolive-Peet Co. v. United States,* 320 U. S. 422, 424. The rule thus applied by this Court in income tax, estate tax and excise tax cases should also have been applied to a case involving liability under the Vinson Act.

Conclusion

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be granted and that the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted

PAUL G. RODEWALD
Attorney for the Petitioner

DAVID B. BUERGER,
Of Counsel.

APPENDIX A

[Excerpts from Appendix A of the Brief of Respondent (Petitioner there) in United States Circuit Court of Appeals for the Third Circuit]

"Appendix A

Act of March 27, 1934, c. 95, 48 Stat. 503 [505]:

Sec. 3. The Secretary of the Navy is hereby directed to submit annually to the Bureau of the Budget estimates for the construction of the foregoing vessels and aircraft; and there is hereby authorized to be appropriated such sums as may be necessary to carry into effect the provisions of this Act: *Provided,* That no contract shall be made by the Secretary of the Navy for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—

(a) To make a report, as hereinafter described, under oath, to the Secretary of the Navy upon the completion of the contract.

(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract price, such amount to become the property of the United States: *Provided,* That if such amount is not voluntarily paid the Secretary of the Treasury may collect the same under the usual methods employed under the internal revenue laws to collect Federal income taxes.

(c) To make no subdivisions of any contract or subcontract for the same article or articles for

the purpose of evading the provisions of this Act, but any subdivision of any contract or subcontract involving an amount in excess of $10,000 shall be subject to the conditions herein prescribed.

(d) That the manufacturing spaces and books of its own plant, affiliates, and subdivisions shall at all times be subject to inspection and audit by any person designated by the Secretary of the Navy, the Secretary of the Treasury, and/or by a duly authorized committee of Congress.

(e) To make no subcontract unless the subcontractor agrees to the foregoing conditions.

The report shall be in form prescribed by the Secretary of the Navy and shall state the total contract price, the cost of performing the contract, the net income, and the per centum such net income bears to the contract price. A copy of such report shall be transmitted to the Secretary of the Treasury for consideration in connection with the Federal income tax returns of the contractor for the taxable year or years concerned.

The method of ascertaining the amount of excess profit to be paid into the Treasury shall be determined by the Secretary of the Treasury in agreement with the Secretary of the Navy and made available to the public. The method initially fixed upon shall be so determined on or before June 30, 1934: *Provided,* That in any case where an excess profit may be found to be owing to the United States in consequence hereof, the Secretary of the Treasury shall allow credit for any Federal income taxes paid or remaining to be paid upon the amount of such excess profit.

The contract or subcontracts referred to herein are limited to those where the award exceeds $10,000.

(U.S.C. 1940 ed., Title 34, Sec. 496.)

Act of June 25, 1936, c. 812, 49 Stat. 1926:

Section 3(b) of an Act entitled "An Act to establish the composition of the United States Navy with respect to the categories of vessels limited by the treaties signed at Washington, February 6, 1922, and at London, April 22, 1930, at the limits prescribed by those treaties; to authorize the construction of certain naval vessels; and for other purposes", approved March 27, 1934 (48 Stat. 505), is hereby amended * * * so that as amended said section 3(b) will read as follows:

'Sec. 3.(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract prices, of such contracts within the scope of this section as are completed by the particular contracting party within the income taxable year, such amount to become the property of the United States, but the surety under such contracts shall not be liable for the payment of such excess profit: *Provided,* That if there is a net loss on all such contracts or subcontracts completed by the particular contractor or subcontractor within any income taxable year, such net loss shall be allowed as a credit in determining the excess profit, if any, for the next succeeding income taxable year: *Provided further,* That if such amount is not voluntarily paid the Secretary of the Treasury shall collect the same under the usual methods employed under the internal-revenue laws to collect Federal

income taxes: *Provided further,* That all provisions of law (including penalties) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, and not inconsistent with this section, shall be applicable with respect to the assessment, collection, or payment of excess profits to the Treasury as provided by this section, and to refunds by the Treasury of overpayments of excess profits into the Treasury: *And provided further,* That this section shall not apply to contracts or subcontracts for scientific equipment used for communication, target detection, navigation, and fire control as may be so designated by the Secretary of the Navy, and the Secretary of the Navy shall report annually to the Congress the names of such contractors and subcontractors affected by this provision, together with the applicable contracts and the amounts thereof: *And provided further,* That the income-taxable years shall be such taxable years beginning after December 31, 1935, except that the above provisos relating to the assessment, collection, payment, or refunding of excess profit to or by the Treasury shall be retroactive to March 27, 1934.' (U.S.C. 1940 ed., Title 34, Sec. 496.)

T.D. 4723, 1937-1 Cum. Bull. 519, 521:

Art. 2. *Contracts and subcontracts under which excess profit liability may be incurred.* — Except as otherwise provided with respect to contracts or subcontracts for certain scientific equipment (see article 3 of these regulations), every contract awarded for an amount exceeding $10,000 and entered into after the enactment of the Act

of March 27, 1934, for the construction or manufacture of any complete naval vessel or aircraft, or any portion thereof, is subject to the provisions of the Act relating to excess profit liability. Any subcontract made with respect to such a contract and involving an amount in excess of $10,000 is also within the scope of the Act. If a contracting party places orders with another party, aggregating an amount in excess of $10,000, for articles or materials which constitute a part of the cost of performing the contract or subcontract, the placing of such orders shall constitute a subcontract within the scope of the Act, unless it is clearly shown that each of the orders involving $10,000 or less is a bona fide separate and distinct subcontract and not a subdivision made for the purpose of evading the provisions of the Act.

I.T. 2930, XIV-2 Cum. Bull. 533 (1936):

Advice is requested relative to the applicability to certain cases of section 3 of the Vinson Act (48 Stat. 503), which provides as follows:

* * * * * * *

The questions on which rulings are requested are stated and answered below:

* * * * * * *

(2) We are receiving orders for materials used in ship construction for the United States Navy and subject to the Vinson Act. We are desirous of obtaining your interpretation of this Act with regard to our status as subcontractors. As an example, take the case of a private shipyard placing an order with a manufacturer of condensers, who in turn would purchase the condenser

tubes from us—would we come under the jurisdiction of the Act in the event this order from the condenser manufacturer exceeds ten thousand ($10,000) dollars?

This question is answered in the affirmative. In this case the provisions of the Act are applicable to the contract, subcontract, or a subdivision thereof.

* * * * * * *

(4) We are desirous of obtaining your interpretation regarding contracts which we have with the United States Navy Department under the Vinson Act, as to whether or not the suppliers of materials used in the fabrication of our products would be considered subcontractors, and therefore, subject to the terms and conditions of the Vinson Act.

Generally speaking, section 3 of the Vinson Act is applicable to any contract or subcontract which is over $10,000 in amount and for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, including items, such as fabricating materials, which become a component part of an article or articles constructed and/or manufactured under the Act.

OFFICE OF THE UNDER SECRETARY
OF THE NAVY, PROCUREMENT
LEGAL DIVISION,

PLD/RGMcC: vmc Washington, July 6, 1942.

Subject: Definition of word 'subcontractor' as used in Section 403, Sixth Supplemental National Defense Act, 1942 (Public Law No. 528, 77th Congress, approved March 27, 1942).

The question has been raised as to what is the proper definition of 'subcontractor' as used in the renegotiation provisions of the Sixth Supplemental National Defense Act, 1942. Practice under the Vinson-Trammel Act for the limitation of profits on contracts for the construction of naval vessels, appears to furnish the best precedents for arriving at such definition.

* * * * * * *

There are no Federal cases under the Vinson-Trammel Act and the related act applicable to Army aircraft contracts; and there do not appear to be any opinions of the Attorney General or of the Comptroller General bearing on the meaning of the word 'subcontract' in such acts.

However, the Judge Advocate General of the Navy has written several opinions as to the application of the Vinson-Trammel Act and these opinions are most helpful in determining what is meant by the word 'subcontract'. In a letter dated September 24, 1936, to The Paraffine Companies, Inc., the JAG said:

> Referring to your letter of August 29, 1936, stating that at times you furnish, as subcontractors, linoleums, paint and asphalt composition roofing for use in the construction of naval vessels, which material you consider as not coming within the purview of the Vinson-Trammel Act of March 27, 1934 (34 U.S.C. 496), this office is of the opinion that the above mentioned Act is applicable to all contracts and subcontracts for materials for complete naval vessels, aircraft or any portion thereof, provided the total contract or subcontract prices are in excess of $10,000.00 and that such materials have not been specifically designated by the Secre-

tary of the Navy as being exempt as scientific equipment under the authority contained in the amendatory Act of June 25, 1936 (Public No. 804).

In a letter to the Secretary of the Navy dated May 18, 1938, the JAG replied to a request as to whether contracts or subcontracts for material not forming a structural portion of the complete vessel fell within the classification of contracts or subcontracts for a 'complete Naval vessel or aircraft' or any portion thereof, as provided in the Act. The JAG cited the 1936 amendment to the Act which exempted therefrom certain scientific equipment, and then went on to say:

> In view of the foregoing, the Judge Advocate General is of the opinion that materials not forming a structural portion of the complete vessel are in general subject to the above mentioned acts, and that the administrative decision as to the exceptions to such rule must be made on the basis of a submission of the conditions affecting the procurement and use of specific items.

By an opinion dated December 16, 1938, to the Secretary of the Navy, the JAG replied to a request 'as to the application of the Vinson-Trammel Act to a contract for services only for the machining of Government owned castings and as to the distinction, if any, between a contract for services for the machining of castings, including the furnishing of jigs, dies and other materials used in the machining of the castings (a contract for services and materials), and a contract for the machining of the castings alone where no materials owned or produced by the machining contractor are delivered to the Government as a part of the service contract.' In this opinion he stated:

3. In the construction of the complete ship or of any portion thereof both labor and material are used; whether the labor and material are furnished by a single contractor or by several contractors, or whether one furnishes labor or services only and another the material, does not change the obligation of a contractor or subcontractor to pay into the Treasury excess profit where the contract or subcontract involves an amount in excess of $10,000.

4. In view of the foregoing, the Judge Advocate General is of the opinion that a contract or subcontract in excess of $10,000 for furnishing labor and material, or labor or material only, if necessary, at any stage, to produce material or equipment ultimately forming a portion of the complete Naval vessel or aircraft, is to be generally considered as coming within the scope of the above mentioned Act.

In January, 1939, the Secretary of the Navy requested the views of the Treasury Department as to the application of the Vinson-Trammel Act to a subcontract for ingots of copper and zinc to be used in the manufacture of cartridge cases. Mr. Hanes, the Acting Secretary of the Treasury, replied in part as follows:

In the specific instance stated, it is understood that the manufacturer (the prospective bidder in this case) is regularly engaged in using ingots of zinc and copper in the manufacture of articles not made under contracts coming within the Vinson-Trammel Act. It is not clear to this Department what the terms and conditions of the commitments referred to will be. It is assumed for purposes of this consideration that the ingot zinc and copper

is ordinary commercial raw zinc and copper which is in fact purchased for general use in the operations of the manufacturer and not for use exclusively in the construction and/or manufacture of articles covered by its contract under the Vinson-Trammel Act; and that the seller of the zinc and copper is not by agreement made subject to any term or condition imposed upon the manufacture under its contract with the Navy Department. The Treasury Department is of the opinion that under these circumstances such ingots of zinc and copper would not constitute portions of a complete naval vessel or aircraft within the scope of the Vinson-Trammel Act, as amended.

It is thus apparent that 'subcontractor' under the Vinson-Trammel Act was held to include a person who furnished materials and supplies under agreement with the contractor, or a person who furnished equipment, tools or machinery (jigs etc.) which were specifically furnished for the purposes of the contract alone (i. e. not for use in the general operation of the contractor's business). It would not appear that in the application of the Vinson-Trammel Act any attempt was made to go beyond the first tier of subcontractors; that is, there is nothing to indicate that it was applied to sub-subcontractors.

46 U.S.C. 1155 (b) (Merchant Marine Act, 1936) provides for a 10% profit limitation on Maritime Commission contracts, applicable to subcontracts, in language similar to the Vinson-Trammel Act. The Maritime Commission has issued regulations under this Act, defining 'subcontract' thus (Para. 22990 Prentice-Hall Government Contracts):

'Subcontract' means any agreement with a contractor for the construction of a complete vessel or portion thereof or for the manufacture or furnishing of any materials or goods or the rendering of any services directly for the construction thereof, but not including services rendered generally to the contractor in connection with the maintenance or operation of the shipyard and not including such intangibles as insurance, surety, expert consultation and the like, or agreements for the furnishing of drawings, plans and other technical information or data.

The practice under the profit limitation statutes appears therefore to have treated uniformly as subcontracts all agreements with the prime contractor relative to the article to be furnished under the prime contract, and there seems to be no justification for any distinction between persons supplying raw materials or machinery and equipment exclusively for use under the prime contract and any other subcontractor furnishing finished component parts of the article covered by the prime contract.

We are of the opinion that the term 'subcontract' as that term is used in Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942 includes the following agreements:

(a) Any purchase order from, or any agreement with, the contractor (i) to perform all or any part of the work to be done or to supply all or any part of the articles to be furnished, under his contract with the Government, (ii) to supply any services required directly for the production of any article or equipment covered by such contract or

any portion thereof, (iii) to make or furnish any supplies, materials, articles or equipment destined to become a component part of any article or equipment covered by such contract, or (iv) to make or furnish any machinery, equipment, tools or supplies acquired by the contractor exclusively for the performance of such contract, but shall not include any agreement to supply machinery, equipment, tools or supplies or other materials or services for the general operation of the contractor's plant or business;

(b) Any purchase order from, or any agreement with, a subcontractor who is obligated to furnish a portion of the completed articles called for under the agreement of the contractor with the Government, if such purchase order or agreement would be construed under paragraph (a) above as a subcontract if entered into with the contractor; and

(c) Any agreement of a subcontractor providing for the delivery to such subcontractor of a portion of the completed articles called for under his subcontract.

For the purpose of the foregoing definition the term 'contractor' must be deemed to be any person, firm or corporation that is a party to an agreement with the Government.

We have construed Section 403 of the Act as generally applicable only to subcontracts in the first tier, i. e., subcontracts entered into directly by the prime contractor with the Government. The renegotiation clause for inclusion in Navy contracts, pursuant to Section 403, as set forth in the letter of the Judge Advocate

General, dated May 30, 1942, approved by the Acting Secretary (JAG:P:FWL:em SO-28780), is keyed in with this construction of the Act, and contemplates inclusion of a renegotiation clause only in those subcontracts let by the prime contractor with the Government. We have, however, deemed it advisable in subparagraphs (b) and (c) above to include also, as within the term 'subcontract' as used in Section 403, certain subcontracts in the second tier of subcontracts. Subparagraph (b) covers the situation where the contractor with the Government has parcelled out or sublet a portion of his contract, in such manner that the subcontractor to whom he has sublet a portion of his contract will furnish to him the completed articles called for by the contract with the Government. In such case the subcontractor furnishing the completed articles called for by the agreement with the Government is, for the purposes of this statute, to be treated as the equivalent of a contractor with the Government, and any subcontracts let by such subcontractor (if they would be construed under subparagraph (a) as a subcontract if entered into with the contractor) are to be considered subcontracts as that term is used in Section 403.

Subparagraph (c) covers the situation where a subcontractor under an agreement with the contractor included within subparagraph (a) above, parcels out or sublets a portion of his subcontract; any agreement for the parcelling out or subletting of such subcontract should also be considered within the term 'subcontract' as that term is used in Section 403.

JOHN KENNEY,
RICHARD G. MCCLUNG."

APPENDIX B

[Excerpts from Brief of Petitioner (petitioner in the Board of Tax Appeals and respondent in the Circuit Court of Appeals) Before Those Tribunals]

(Before the Board of Tax Appeals)

"II.

In Computing Excess Profit, Metal Should be Included in 'Cost of Performing the Contract' at Its Value at the Time of Appropriation to the Contract.

This issue, which concerns the proper computation of the 'cost of performing the contract', applies to the prime contracts made by the petitioner with the Navy Department, and is the only issue raised with respect to those contracts. Alternatively, it also concerns the job contracts and material orders, as to which the petitioner insists that it is not subject to the Vinson Act because it was not a subcontractor. As to these, the petitioner takes the further position that even if it were a subcontractor, the 'cost of performing the contract' should in each instance, as in the case of prime contracts, be computed upon the basis of including metal at its 'schedule cost', i. e., its fair market value at the time it was set aside for performance of the particular contract. For convenience in our discussion of this issue, we shall ordinarily speak of the petitioner's prime contracts; the arguments made apply equally to job contracts and material orders.

At various times and in the ordinary course of its business, the petitioner produced or acquired and held in stock for its general corporate purposes metal consisting of pig aluminum, aluminum scrap, secondary aluminum ingot, and other metals used for alloying

(Stipulation, par. 2). Certain of this metal—not more than two per cent. of the entire amount—the petitioner appropriated for use in connection with the prime contracts, job contracts, and material orders involved in this case (R. 44). Until the metal was so appropriated and set aside, it was a part of an aggregate inventory of metal produced by the petitioner for commercial purposes to be fabricated and sold to commercial customers. The present issue concerns the price at which the metal is to be included in determining 'the cost of performing the contract'.

* * * * * * *

The petitioner accordingly contends that since the 'controlling date' is the date on which the metal was set aside for performance of the Navy contract, the 'cost' of materials to be included in the 'cost of performing the contract' is the fair market value of the materials at that controlling date.

* * * * * * *

On the basis of the foregoing authorities it would seem to follow *a fortiori* that the value at which the metal is to be taken into cost of performance should not be less than its value when the Vinson Act was passed. The Act is extreme in its impact upon business activities and calls for an outright taking rather than the imposition of a fractional tax, and for this reason the authorities under income tax and other laws holding that a retrospective application is not to be given to such laws apply with greater force here.

* * * * * * *

The principal against taxing preexisting profits (or seizing them outright, which is worse), was described in the *Turrish* case (247 U. S. 221, 230) as 'resistless except against an intention imperatively clear'. That

intention, we submit, is entirely lacking in the Vinson Act and, as we have pointed out, there is nothing in the regulations promulgated under that Act to call for retrospective application of its recapture provisions. If it should be determined, despite the authorities relied on by the petitioner, that in the case of metal produced after March 27, 1934, the original cost of the metal is to be included in the cost of performing the contract, the authorities above cited call in any event for the inclusion in cost of performance of metal on hand on the effective date of the Vinson Act at its fair market value on that date."

(Before the Circuit Court of Appeals)

"II.

The excess profit on a subcontract for the construction or manufacture of a vessel or aircraft authorized by the Vinson Act does not include profit resulting from an increase in the value of the metal occurring prior to the message of the act.

* * * * * * *

The question here is whether the Vinson Act is to have a retroactive application.

* * * * * * *

It cannot be said that there is anything in the Vinson Act justifying retroactive application, any more than in the 1909 or 1913 Acts construed by the Supreme Court.

* * * * * * *

That intention, we submit, is entirely lacking in the Vinson Act, and the Supreme Court decisions above cited call for the exclusion from the 'excess profit' derived from the construction of a Vinson Act naval vessel

or aircraft all profit resulting from the increase in the value of the metal occurring prior to the passage of the Act."

APPENDIX C

[Cases Holding That a Materialman Is Not a "Subcontractor"]

Staples v. Adams, Payne & Gleaves, 215 Fed. 322 (C.C.A. 4)

Northwest Roads Co. v. Clyde Equipment Company, 79 F. (2d) 771 (C.C.A. 9)

Hihn-Hammond Lumber Co. v. Elsom, 171 Cal. 570, 154 Pac. 12

John A. Roebling's Sons Co. v. Humboldt Electric Light & Power Co., 112 Cal. 288, 44 Pac. 568

Garbutt v. Chappe, 131 Cal. App. 284, 21 Pac. (2d) 594

Harris & Stunston, Inc. v. Yorba Linda Citrus Ass'n., 135 Cal. App. 154, 26 Pac. (2d) 654

Farmers Irrigation Co. v. Kamm, 55 Colo. 440, 135 Pac. 766

Chapin v. Persse & Brooks Paper Works, 30 Conn. 461

Hackfield & Co. v. Hilo Railroad Co., 14 Hawaii 448

Alexander Lumber Co. v. Farmer City, 272 Ill. 264, 11 N. E. 1012

Farmers Loan & Trust Co. v. Canada & St. Louis Ry. Co., 127 Ind. 250, 26 N. E. 784

Tipton Realty & Abstract Co. v. Kokomo Stone Co., 61 Ind. App. 681, 110 N. E. 688

Forsberg v. Koss Construction Co., 218 Iowa 818, 252 N. W. 258

Hightower v. Bailey, 108 Ky. 198, 56 S. W. 147

American Creosote Works v. City of Monroe, 175 La. 905, 144 So. 612

Staffon v. Lyon, 104 Mich. 249, 62 N. W. 354

Stephens Lumber Co. v. Townsend-Stark Corp., 228 Mich. 182, 199 N. W. 706

Vander Horst v. Apartments Corp., 239 Mich. 593, 215 N. W. 57

Carlisle v. Knapp, 51 N. J. Law 329, 17 Atl. 633

Bohnen v. Metz, 126 N. Y. App. Div. 807, 111 N. Y. Supp. 196 (affirmed 193 N. Y. 676, 87 N. E. 1116)

Herrmann & Grace v. City of New York, 130 N. Y. App. Div. 531, 114 N. Y. Supp. 1107

Edward E. Buhler Co. v. New York Dock Co., 170 N. Y. App. Div. 486, 156 N. Y. Supp. 457

Heddon Construction Co. v. Procter & Gamble Co., 62 N. Y. Misc. 129, 114 N. Y. Supp. 1103

Matzinger v. Harvard Lumber Co., 115 Ohio St. 555, 155 N. E. 131

Fisher v. Tomlinson, 40 Ore. 111, 66 Pac. 696

Brown v. Cowan, 110 Pa. 588, 1 Atl. 520

Huddleston v. Nislar, 72 S. W. (2d) (Texas) 959

Austin Bridge Co. v. Drake, 79 S. W. (2d) (Texas) 677

Baker v. Yakima Valley Canal Co., 77 Wash. 70, 137 Pac. 342

Neary v. Puget Sound Engineering Company, 114 Wash. 1, 194 Pac. 830

Marsh v. Rothey, 117 W. Va. 94, 183 S. E. 914

Builders Lumber & Supply Co. v. Chicago Bonding & Surety Co., 167 Wis. 167, 166 N. W. 320.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	2
Argument	7
Conclusion	15
Appendix	16

CITATIONS

Cases:	
Biddle v. *Commissioner*, 302 U. S. 573	10
Doyle v. *Mitchell Brothers Co.*, 247 U. S. 179	14
Hays v. *Gauley Mt. Coal Co.*, 247 U. S. 189	14
Helvering v. *Griffiths*, 318 U. S. 371	9
Helvering v. *Lerner Stores Corp.*, 314 U. S. 463	12
Helvering v. *N. Y. Trust Co.*, 292 U. S. 455	10
Helvering v. *Pfeiffer*, 302 U. S. 247	12
Helvering v. *Winmill*, 305 U. S. 79	9
LeTulle v. *Scofield*, 308 U. S. 415	12
Lynch v. *Hornby*, 247 U. S. 339	14
Lynch v. *Turrish*, 247 U. S. 221	14
MacEvoy Co. v. *United States*, 322 U. S. 102	10, 11
Merchants' L. & T. Co. v. *Smietanka*, 255 U. S. 509	14
Sanford, Estate of v. *Commissioner*, 308 U. S. 39	10
Ryerson v. *United States*, 312 U. S. 405	12
United States v. *Cleveland &c. Ry. Co.*, 247 U. S. 195	14
United States v. *Dakota-Montana Oil Co.*, 288 U. S 459	9
Statutes:	
Act of March 27, 1934, c. 95, 48 Stat. 503, Sec. 3, as amended by the Act of June 25, 1936, c. 812, 49 Stat. 1926 (34 U. S. C. Sec. 496)	2, 3, 7, 12, 16
Act of June 25, 1936, c. 812, 49 Stat. 1926, (34 U. S. C. Sec. 496)	18
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 801 (50 U. S. C. App., Supp. III, Sec. 1191)	9
Second Revenue Act of 1940, c. 757, 54 Stat. 974, Sec. 401 (34 U. S. C. Sec. 496a)	11
Sixth Supplemental National Defense Appropriation Act, 1942, c. 247, 56 Stat. 226, Sec. 403 (50 U. S. C. Supp. III, Sec. 1191)	9

604606—44——1

Miscellaneous: Page
Magill, Taxable Income 28, note 17, 93 *et seq.* ---- 14
T. D. 4434, XIII–1 Cum. Bull. 540 (1934) ---- 12, 19
T. D. 4723, 1937–1 Cum. Bull. 519:
Art. 1 ---- 8, 20
Art. 2 ---- 8, 20
Art. 8 ---- 13, 21

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 286

ALUMINUM COMPANY OF AMERICA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinions of the Board of Tax Appeals (R. 4–28) are reported in 47 B. T. A. 543. The opinion of the Circuit Court of Appeals (R. 49–63) is reported in 142 F. 2d 663.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 28, 1944 (R. 64). The petition for a writ of certiorari was filed on July 26, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Is petitioner liable under Section 3 of the Vinson Act to repay into the Treasury profits in excess of 10 percent of the contract price of aluminum furnished during the years 1936, 1937 and 1938 for the construction of naval vessels and aircraft or portions thereof?

2. Petitioner urged before the Board of Tax Appeals that in computing profit it was entitled to ascribe to metal on hand at the time of enactment of the Vinson Act a cost equal to its value on that date. The Board decided this point against petitioner, and petitioner did not appeal. However, on the Commissioner's appeal to the Circuit Court, petitioner renewed the argument. Was petitioner, having failed to appeal, in a position to raise this point and, if so, does it contain any merit?

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations appear in the Appendix, *infra,* pp. 16–24.

STATEMENT

This case involves the petitioner's liability under Section 3 of the Vinson Act[1] to pay into the Treasury profits in excess of 10 percent of the contract price of aluminum furnished during the years 1936, 1937 and 1938 for the construction

[1] Act of March 27, 1934, c. 95, 48 Stat. 503, as amended by the Act of June 25, 1936, c. 812, 49 Stat. 1926.

of naval vessels and aircraft or portions thereof. Section 3 (b) of the Act provided for the collection of such excess profits by the usual methods employed under the internal revenue laws to collect federal income taxes. Following determinations of deficiencies for the years in question by the Commissioner of Internal Revenue, petitioner filed petitions for redetermination with the Board of Tax Appeals (R. 2, 3, 4). The facts found by the Board may be summarized as follows:

Petitioner, a Pennsylvania corporation, with its principal office in Pittsburgh, was engaged in the business of producing, purchasing and selling aluminum and its alloys either as ingot or in partly or wholly fabricated forms (R. 6). During the years 1937 and 1938 it delivered, pursuant to job contracts, aluminum materials to prime contractors engaged in the construction of complete naval vessels. Under this type of contract, petitioner agreed to furnish, and the prime contractor agreed to buy, not less than, nor more than, designated amounts of described aluminum materials for use in the construction of a named naval vessel or vessels. The material was to be sold at prices stated in the contract for particular classes of material, reference being made for prices to petitioner's regular published price list incorporated in the contract, but the purchaser was not required to buy any quantity of

any particular class of material. (R. 7–8.)[2] In addition to the aluminum furnished under the job contracts, petitioner furnished, during the years involved, for use in construction of naval vessels and aircraft or parts thereof, certain aluminum materials on orders received from customers (R. 11–14).[3]

With the exception of small amounts of certain quilting bolt nuts made specially for use in naval vessels, all of the materials furnished under these job contracts and orders were regular commercial products. At least 98 percent of petitioner's commercial products were used by other purchasers for purposes unrelated to the Vinson Act. The prices charged for the materials furnished under these job contracts and orders were identical with the prices charged other purchasers for like materials, and the procedure in the handling of the orders, the processes of manufacture, the method of shipping and accounting was the same as that followed under other commercial orders. (R. 9–10, 11.)

After delivery by petitioner, the aluminum materials, except for small quantities of screws, nuts and bolts, required further extensive fabrication. This fabrication involved operations such as the cutting to size, forming, punching, riveting,

[2] The excerpts appearing in the Record at pages 30–33 are excerpts from a typical contract of this kind.

[3] The excerpts appearing in the Record at pages 34–45 are typical of this kind of order.

welding, drilling, perforating, painting and assembling of sheet, plate, and structural and extruded shapes, the forming, threading, drilling, welding, riveting and installation of tubing, the machining of rod and bar, and the grinding, drilling and threading of sand castings. Such fabrication resulted in radical distortion in size and shape of the material furnished by petitioner and its conversion into new and different forms. (R. 10, 12, 14–15.)

The Commissioner of Internal Revenue determined that petitioner was subject to the profit-limiting provisions of the Vinson Act with respect to the business which has been described above, and determined a deficiency in the petitioner's excess profit liability for the years 1936, 1937 and 1938, accordingly. The Board of Tax Appeals held, three members dissenting, that with respect to the described business petitioner was not subject to the profit-limiting provisions of the Vinson Act, and entered decisions accordingly. (R. 4–29.) The Commissioner appealed and the Circuit Court of Appeals reversed, holding that the profit-limiting provisions were applicable to the described business (R. 49–63).

In addition to the job contracts and orders referred to above, petitioner held certain prime contracts with the Navy upon which it was concededly subject to profit limitation (R. 7). Petitioner contended before the Board of Tax Appeals that its profit on these contracts (and on the job

contracts and orders, if it should be held that profit limitation applied to them) should be computed by taking as the cost of the metal the value thereof at the date of its appropriation to the respective contracts, or in the alternative, that with respect to metal on hand on the date of enactment of the Vinson Act the cost of that metal should be taken to be its fair market value on that date. The Commissioner contended that the cost of the metal was the actual amount expended in acquiring or producing it. (R. 6–7.) This issue was decided against petitioner and petitioner did not appeal (R. 23–25, 63).

In the Circuit Court of Appeals, petitioner renewed the alternative contention which it had made before the Board, namely, that if it should be held subject to profit limitation on the job contracts and orders, then with respect to metal on hand at the time of enactment of the Vinson Act the fair market value of such metal on that date should be taken as its cost for the purpose of computing the amount of prof Although the Government did not argue that petitioner was not in a position to raise this question insofar as it related to the job contracts and orders, the Circuit Court of Appeals held that since the Board had ruled upon this issue adversely to petitioner and petitioner had not petitioned for review, petitioner could not raise it in the appellate court. (R. 62–63.)

ARGUMENT

1. As its title indicates (48 Stat. 503), the Vinson Act was enacted in order to authorize the President to bring the navy up to the strength allowed by the Washington and London naval treaties. The profit-limiting provisions embodied in Section 3 (Appendix, *infra*, pp. 16–17) were designed to serve the double purpose of achieving economy in the cost of the program and of preventing the making of unconscionable profits out of the Nation's need for defense. This Section provided for the inclusion in all contracts made for the construction of any naval vessel or aircraft, or portion thereof, of a provision requiring the contractor to pay into the Treasury all profits in excess of 10 percent of the contract price and to make no subcontract unless the subcontractor agreed to similar conditions. All contracts were also to provide that no subdivision of any contract or subcontract should be made for the purpose of evading the provisions of the Act, but that all subdivisions of any contract or subcontract were to be subject to the same conditions. Section 3 further provided that it was to be applicable only to contracts or subcontracts in which the award exceeded $10,000.

With respect to the primary question here involved, *i. e.*, the scope of Section 3, we think that the decision of the Circuit Court of Appeals is plainly correct and since there is no conflict and

the whole question is of limited importance, there is no occasion for further review.

(a) Petitioner contends that Section 3 applies only to contractors and subcontractors and that one who supplies material for use in the performance of a contract cannot be a subcontractor within the meaning of the Act. However, it is clear, as petitioner concedes (Pet. 18–21), that under the regulations promulgated jointly by the Secretaries of the Navy and Treasury under the Vinson Act, the job contracts and orders here involved are subject to profit limitation. See Articles 1 (g) and 2 of T. D. 4723 (Appendix, *infra,* pp. 20–21). As the Circuit Court of Appeals pointed out (R. 58–62), this has been the consistent administrative construction under this and similar legislation by the War, Navy and Treasury Departments, and the Maritime Commission; the attention of Congress was expressly and specifically drawn to this very point on at least two occasions when it was engaged in revision of this legislation (see R. 58–60), and upon one of these occasions it was charged that application of profit limitation to suppliers of material constituted a serious impediment to expeditious development of the national defense program; that nevertheless, and despite the fact that in statutes enacted in 1936, 1939 and 1940, many detailed changes were made in this legislation, Congress did not see fit to change this as-

pect of its operation; and finally when the Board's decision in the instant case cast doubt upon the meaning of similar language used in Section 403 (b) of the Sixth Supplemental National Defense Appropriation Act, 1942, c. 247, 56 Stat. 226, the original renegotiation provision, Congress specifically incorporated the administrative construction into the law by Section 801 of the Revenue Act of 1942, c. 619, 56 Stat. 798 (50 U. S. C. App., Supp. III, Sec. 1191). (See R. 58–62.)

This legislative history presents an unquestionably plain case of Congressional approval of the administrative construction, and under the familiar rule the regulation must be given the force and the effect of law. *United States* v. *Dakota-Montana Oil Co.,* 288 U. S. 459; *Helvering* v. *Winmill,* 305 U. S. 79, 83; *Helvering* v. *Griffiths,* 318 U. S. 371, 395–397. There is therefore no basis for petitioner's contention that the regulation is invalid and should have been struck down.

There is no warrant for petitioner's charge (Pet. 20–21) that the administrative construction was not consistent and was not followed in actual practice. This charge is based upon a statement in an unpublished memorandum (Pet. 31–38) prepared in the Office of the Under Secretary of the Navy in which it is said (Pet. 35):

> It would not appear that in the application of the Vinson-Trammell Act any attempt was made to go beyond the first tier of

> subcontractors; that is, there is nothing to indicate that it was applied to sub-subcontractors.

However, this is by no means a statement that in the administration of the Vinson Act, applicability of the profit-limiting provisions was cut off in practice at "the first tier of subcontractors". It is merely a statement that so far as the investigation of the Vinson Act conducted by the writers of that memorandum disclosed (an investigation which appears to have been confined mainly to the correspondence of the Judge Advocate General of the Navy), they had found no instances of application of the profit-limiting provisions of the Vinson Act to "sub-subcontractors". The memorandum does not state that its writers had found anything to indicate that the Act had been held to be not applicable "beyond the first tier of subcontractors". The administrative construction is shown by the officially published regulations (cf. *Helvering* v. *N. Y. Trust Co.,* 292 U. S. 455; *Biddle* v. *Commissioner,* 302 U. S. 573; *Estate of Sanford* v. *Commissioner,* 308 U. S. 39), and in any event there is no inconsistency between the memorandum and the regulations.

(b) Since the instant case is the only decision of a Circuit Court of Appeals upon this aspect of the Vinson Act, there is no direct conflict upon the question. Moreover, the decision not only does not conflict with the rationale of *MacEvoy*

Co. v. *United States,* 322 U. S. 102, which arose under the Miller Act,[4] but indeed follows the teaching of that case that the meaning of the word "subcontractor" must in each instance be ascertained from the purpose and context of the statute in which it appears. The *MacEvoy* case points out (322 U. S. at p. 108) that "the word has no single exact meaning", that it may include "one who has a contract to furnish labor or material to the prime contractor" and refutes petitioner's suggestion (Pet. 8, 14–18) that it is an immutable word of art which cannot in any circumstances include a supplier of material.

(c) The issue does not seem to be one of such widespread importance as to warrant further review in the absence of a conflict. The profit-limiting provisions of the Vinson Act have been suspended for the future by Section 401 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, and a survey made by the Bureau of Internal Revenue reveals that the cases pending in the Bureau or before the Tax Court total only eleven and that the gross amount involved in these cases totals approximately $290,000.

2. The court below held that petitioner could not raise there the contention that its profits should be measured by ascribing to the metal on hand at the time of enactment of the Vinson Act a cost equal to its value on that date.

[4] Act of August 24, 1935, c. 642, 49 Stat. 793.

Although the Government did not suggest to the court this disposition of the issue, the court rested its conclusion on *Helvering* v. *Pfeiffer,* 302 U. S. 247. Compare such cases as *LeTulle* v. *Scofield,* 308 U. S. 415; *Ryerson* v. *United States,* 312 U. S. 405; and *Helvering* v. *Lerner Stores Corp.,* 314 U. S. 463. In any event, we do not believe that the instant case affords a proper vehicle for determination of any procedural question which might be thought to be present, since we think it plain that in this litigation the point has no more than academic interest, for there is no merit in petitioner's substantive contention.

Before the Board of Tax Appeals, petitioner contended that its profit on all of the business involved should be computed by taking for its "cost" (sec. 3 (e) of the Vinson Act) the market value of the metal at the time it was appropriated to the various contracts. But as the Board held (R. 23–25), there is no warrant either in the Act or the regulations for such a course.

The Act provides that the method of ascertaining the amount of profit shall be determined by the Secretaries of the Treasury and Navy. Pursuant to this authorization, T. D. 4434, Appendix, *infra,* pp. 19–20) provided that the cost of performance should be the direct costs, such as labor and material, plus a reasonable

proportion of indirect costs appertaining to the contract. Article 8 of T. D. 4723 (Appendix, *infra,* pp. 21–24) contains similar language, and in addition defines, in general, the elements of cost. It will be observed that this regulation provides that factory cost shall include the cost of material "purchased for stock and subsequently issued for contract operations", and furthermore specifically lists as among the items not includible in cost "amortization of unrealized appreciation of values of assets" (pp. 22, 23, *infra*).

Petitioner's theory of computation of profit would, as the Board pointed out (R. 24), defeat the fundamental purpose of the Act, and indeed would nullify application of the Act to the petitioner for, under petitioner's view, all of its profit would have been earned in the production of the aluminum (since at the time of sale it was worth the price it then brought) and there would be no profit upon which the Vinson Act could apply.

In the Circuit Court of Appeals, petitioner limited its contention upon this issue to the narrower ground that its theory should be applied to so much of the metal as was on hand on the date of the enactment of the Vinson Act. But the entire theory is baseless, and there is certainly nothing in the Act or the regulations to support differing methods of computation of profit turning upon when the contractor acquired the raw materials.

In no sense is the question one of retroactive application of the Vinson Act. The question simply is, what was petitioner's profit when it sold the aluminum here involved? It would seem to be plain that if it cost a certain amount to produce a pound of aluminum which was later sold for a larger amount, the profit would be the difference between the former and latter sums regardless of when the aluminum was produced.

The cases cited by petitioner (Pet. 25) are not in point. *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179; *Hays* v. *Gauley Mt. Coal Co.*, 247 U. S. 189; and *United States* v. *Cleveland &c. Ry. Co.*, 247 U. S. 195, turned largely upon the consistent administrative interpretation of the statute there involved. See 247 U. S. at pp. 185–187. In *Lynch* v. *Turrish*, 247 U. S. 221, the statute specifically stated that only income accruing after March 1, 1913, should be subject to tax. Moreover, all of these cases involved capital gains (the opinions stress this point) and were decided at a time when it was still a lively question whether capital gains were income at all, a question not finally settled until the decision in *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509. See Magill, Taxable Income 28, note 17, 93 *et seq.*

An income tax case more closely parallel to the question here involved is *Lynch* v. *Hornby*, 247 U. S. 339. There it was held that the entire

amount of a corporate dividend was taxable as income, even though it was extraordinary in amount ($650,000 on a capital stock of $1,000,000) and represented earnings of the corporation prior to March 1, 1913.

CONCLUSION

The decision below is correct and involves no conflict of decisions or question of general importance. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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AUGUST 1944.

APPENDIX

Act of March 27, 1934, c. 95, 48 Stat. 503:

SEC. 3. The Secretary of the Navy is hereby directed to submit annually to the Bureau of the Budget estimates for the construction of the foregoing vessels and aircraft; and there is hereby authorized to be appropriated such sums as may be necessary to carry into effect the provisions of this Act: *Provided,* That no contract shall be made by the Secretary of the Navy for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—

(a) To make a report, as hereinafter described, under oath, to the Secretary of the Navy upon the completion of the contract.

(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract price, such amount to become the property of the United States: *Provided,* That if such amount is not voluntarily paid the Secretary of the Treasury may collect the same under the usual methods employed under the internal revenue laws to collect Federal income taxes.

(c) To make no subdivisions of any contract or subcontract for the same article or articles for the purpose of evading the provisions of this Act, but any subdivision of any contract or subcontract involving an

amount in excess of $10,000 shall be subject to the conditions herein prescribed.

(d) That the manufacturing spaces and books of its own plant, affiliates, and subdivisions shall at all times be subject to inspection and audit by any person designated by the Secretary of the Navy, the Secretary of the Treasury, and/or by a duly authorized committee of Congress.

(e) To make no subcontract unless the subcontractor agrees to the foregoing conditions.

The report shall be in form prescribed by the Secretary of the Navy and shall state the total contract price, the cost of performing the contract, the net income, and the per centum such net income bears to the contract price. A copy of such report shall be transmitted to the Secretary of the Treasury for consideration in connection with the Federal income tax returns of the contractor for the taxable year or years concerned.

The method of ascertaining the amount of excess profit to be paid into the Treasury shall be determined by the Secretary of the Treasury in agreement with the Secretary of the Navy and made available to the public. The method initially fixed upon shall be so determined on or before June 30, 1934: *Provided,* That in any case where an excess profit may be found to be owing to the United States in consequence hereof, the Secretary of the Treasury shall allow credit for any Federal income taxes paid or remaining to be paid upon the amount of such excess profit.

The contract or subcontracts referred to herein are limited to those where the award exceeds $10,000.

(34 U. S. C. Sec. 496.)

Act of June 25, 1936, c. 812, 49 Stat 1926:

> * * * section 3 (b) of an Act entitled "An Act to establish the composition of the United States Navy with respect to the categories of vessels limited by the treaties signed at Washington, February 6, 1922, and at London, April 22, 1930, at the limits prescribed by those treaties; to authorize the construction of certain naval vessels; and for other purposes", approved March 27, 1934 (48 Stat. 505), is hereby amended * * * so that as amended said section 3 (b) will read as follows:
>
> "SEC. 3. (b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract prices, of such contracts within the scope of this section as are completed by the particular contracting party within the income taxable year, such amount to become the property of the United States, but the surety under such contracts shall not be liable for the payment of such excess profit: *Provided,* That if there is a net loss on all such contracts or subcontracts completed by the particular contractor or subcontractor within any income taxable year, such net loss shall be allowed as a credit in determining the excess profit, if any, for the next succeeding income taxable year: *Provided further,* That if such amount is not voluntarily paid the Secretary of the Treasury shall collect the same under the usual methods employed under the internal-revenue laws to collect Federal income taxes: *Provided further,* That all provisions of law (including penalties) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, and not inconsistent

with this section, shall be applicable with respect to the assessment, collection, or payment of excess profits to the Treasury as provided by this section, and to refunds by the Treasury of overpayments of excess profits into the Treasury: *And provided further,* That this section shall not apply to contracts or subcontracts for scientific equipment used for communication, target detection, navigation, and fire control as may be so designated by the Secretary of the Navy, and the Secretary of the Navy shall report annually to the Congress the names of such contractors and subcontractors affected by this provision, together with the applicable contracts and the amounts thereof: *And provided further,* That the income-taxable years shall be such taxable years beginning after December 31, 1935, except that the above provisos relating to the assessment, collection, payment, or refunding of excess profit to or by the Treasury shall be retroactive to March 27, 1934." (34 U. S. C. Sec. 496.)

T. D. 4434, XIII–1 Cum. Bull. 540, 541, 542 (1934):

> The method of ascertaining the amount of excess profit to be paid to the United States in respect of contracts entered into under the Vinson Act shall be as follows:
>
> The excess profit shall be determined on each contract separately upon the completion or other termination of the contract. The amount of such excess profit shall be the amount of the profit on the contract in excess of 10 percent of the total contract price. The amount of the profit on the contract shall be the difference between the total contract price and the cost of per-

forming the contract. The cost of performing the contract shall be the direct costs, such as material and labor, incurred by the contractor in performing the contract, plus a reasonable proportion of any indirect costs (including overhead or general expenses) appertaining to the contract which are not usually directly allocated to the cost of performing the contract. No general rule may be stated for ascertaining the reasonable proportion of the indirect costs to be allocated to the cost of performing a contract which would be applicable to all cases. The proper proportion of the indirect costs to be applied to the cost of performing a particular contract depends upon all the facts and circumstances relating to the performance of the particular contract. The contractor shall include as a part of the report required to be made to the Secretary of the Navy upon the completion or other termination of the contract, a statement explaining the manner in which such indirect costs were determined and allocated to the cost of performing the contract.

* * * * *

T. D. 4723, 1937–1 Cum. Bull. 519, 520, 521, 523:

ARTICLE 1. *Definitions.*—As used in these regulations the term—

* * * * *

(g) "Contracting party" means a contractor or subcontractor as the case may be.

* * * * *

ART. 2. *Contracts and subcontracts under which excess profit liability may be incurred.*—Except as otherwise provided

with respect to contracts or subcontracts for certain scientific equipment (see article 3 of these regulations), every contract awarded for an amount exceeding $10,000 and entered into after the enactment of the Act of March 27, 1934, for the construction or manufacture of any complete naval vessel or aircraft, or any portion thereof, is subject to the provisions of the Act relating to excess profit liability. Any subcontract made with respect to such a contract and involving an amount in excess of $10,000 is also within the scope of the Act. If a contracting party places orders with another party, aggregating an amount in excess of $10,000, for articles or materials which constitute a part of the cost of performing the contract or subcontract, the placing of such orders shall constitute a subcontract within the scope of the Act, unless it is clearly shown that each of the orders involving $10,000 or less is a bona fide separate and distinct subcontract and not a subdivision made for the purpose of evading the provisions of the Act.

* * * * *

ART. 8. *Cost of performing a contract or subcontract.*—(a) *General rule.*—The cost of performing a particular contract or subcontract shall be the sum of (1) the direct costs, including therein expenditures for materials, direct labor and direct expenses, incurred by the contracting party in performing the contract or subcontract; and (2) the proper proportion of any indirect costs (including therein a reasonable proportion of management expenses) incident to and necessary for the performance of the contract or subcontract.

(b) *Elements of cost.*—No definitions of the elements of cost may be stated which

are of invariable application to all contractors and subcontractors. In general, the elements of cost may be defined for purposes of the Act as follows:

(1) Manufacturing cost, which is the sum of factory cost (see paragraph (c) of this article) and other manufacturing cost (see paragraph (d) of this article);

(2) Cost of installation and construction (see paragraph (e) of this article); and

(3) General expenses, which are the sum of indirect engineering expenses, usually termed "engineering overhead" (see paragraph (f) of this article) and expenses of administration, usually termed "administrative overhead" (see paragraph (g) of this article).

(c) *Factory cost.*—Factory cost is the sum of the following:

(1) *Direct materials.*—Materials, such as those purchased for stock and subsequently issued for contract operations and those acquired under subcontracts, which become a component part of the finished product or which are used directly in fabricating, converting or processing such materials or parts.

(2) *Direct productive labor.*—* * *

(3) *Direct engineering labor.*—* * *

(4) *Miscellaneous direct charges.*—* * *

(5) *Indirect factory expenses.*—* * *

(A) *Labor.*—* * *

(B) *Material and supplies.*—* * *

(C) *Service expenses.*—* * *

(D) *Fixed charges.*—* * *

(E) *Miscellaneous indirect factory expenses.*—* * *

(d) *Other manufacturing cost.*—* * *

(e) *Cost of installation and construction.*—* * *

(f) *Indirect engineering expenses.*—* * *

(1) *Labor.*—* * *

(2) *Material.*—* * *

(3) *Miscellaneous expenses.*—* * *

(g) *Expenses of administration.*—* * *

(1) *Compensation for personal services of employees.*—* * *

(2) *Expenses.*—* * *

Allowances for interest on invested capital are not allowable as costs of performing a contract or subcontract.

Among the items which shall not be included as a part of the cost of performing a contract or subcontract or considered in determining such cost, are the following: Selling expenses, including compensation of employees engaged in selling, operation and maintenance of sales offices, commissions, advertising and demonstrations, depreciation of sales equipment, gratis service, entertainment expenses; dues and memberships other than of regular trade associations; donations; commercial traveling expenses and the like; losses on other contracts; losses from sales or exchanges of capital assets; extraordinary expenses due to strikes or lockouts; fines and penalties; amortization of unrealized appreciation of values of assets; expenses and depreciation of idle plant; increases in reserve accounts for contingencies, repairs, compensation insurance and guarantee work; Federal and State income and excess profits taxes and surtaxes; cash discount earned up to 1 percent of the amount of the purchase, except that all discounts on subcontracts subject to the Act will be considered; interest incurred or earned;

bond discount or finance charges; income from royalties; premiums for life insurance on the lives of officers; legal and accounting fees in connection with reorganizations, security issues, capital stock issues and the prosecution of claims against the United States (including income tax matters); taxes and expenses on issues and transfers of capital stock; losses on investments; bad debts; and expenses of collection and exchange.

In order that the cost of performing a contract or subcontract may be accounted for clearly, the amount of any excess profits repayable to the United States pursuant to the Act should not be charged to or included in such cost.

Excessive or unreasonable payments whether in cash, stock or other property ostensibly for salaries, bonuses or other compensation for personal services, may not be included in the cost of performing a contract or subcontract.

(h) *Allocation of indirect costs.*—* * *

(1) *Factory indirect expenses.*—* * *

(2) *Engineering indirect expenses.*—* * *

(3) *Administrative expenses (or "overhead").*—* * *

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